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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM A. D. 1936

NO. 10

JOSEPH H. BARWISE AND GEORGE THOMPSON, JR.
AS TRUSTEES OF THE ESTATE OF MRS. M. M. (W. I.) COOK, DECEASED.

APPELLANTS,

VS.

GEORGE H. SHEPPARD,
AS COMPTROLLER OF THE STATE OF TEXAS, ET AL.,

APPELLEES.

APPELLANTS' PETITION FOR REHEARING

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Appellants pray a rehearing herein, and as grounds respectfully represent:

We do not question the power of the State to lay an

excise on the production of oil, or to apportion it on those who engage in the production of oil.

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1. Defining excises, Mr. Justice Field in Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 592, said:

> "Excises are a species of tax consisting generally of duties laid upon the manufacture, sale, or consumption of commodities within the country, or upon certain callings or occupations, often taking the form of exactions for licenses to pursue them. The taxes created by the law under consideration as applied to savings banks, insurance companies, whether of fire, life, or marine, to building or other associations, or to the conduct of any other kind of business, are excise taxes."

Taxes on the use of carriages, Hylton v. United States 3 Dall. 171, on sales at exchanges or boards of trade, Nicol v. Ames, 173 U. S. 509, on the transmission of property from the dead to the living, Knowlton v. Moore, 178 U. S. 41, on agreements to sell shares of stock, denominated "calls" by stock brokers, Treat v. White, 181 U. S. 264, on tobacco manufactured for consumption, Patton v. Brady, 184 U. S. 608, on manufactures of cheese, Cornell v. Coyne, 192 U. S. 418, on the sale of oleomargarine artificially colored, McCray v. United States, 195 U. S. 27, on sale of shares of corporations generally, Thomas v. United States, 192 U. S. 363, on the business of transfer companies, Binns v. United States, 194 U. S. 486, on the amounts insured, renewed, and continued by insurance companies, on the gross amounts of premiums received, on dividends undistributed sums, and income, Pacific Ins. Co. v. Soule, 7 Wall. 433, on the amount of state bank notes paid out by banks, Veazie Bank v. Fenno, 8 Wall 533, on devolutions of title to real estate, Scholey v. Rew, 23 Wall, 331, and on the gross receipts of companies engaged in refining sugar, in excess of a named sum,

But, appellants, as lessors, have no community of interest or joint relationship or joint ownership or common right in the undertaking engaged in by their lessee.[2] The language of the opinion defines their relation to be that of partners.[3] The lessee's purpose is entirely distinct and independent and appellants have no reciprocal or mutual relationship thereto, or share in the profits as such.[4]

Spreckles Sugar Refining Co. v. McClain, 192 U. S. 297, have all been upheld as excises.

2. See notes 5, 7, 10, 15, 16, 18, 19, 20, 24, 25, 27, 37, 38, 39.

3. "Those persons are partners, who contribute either property or money to carry on a joint business for their common benefit, and who own and share the profits thereof in certain proportions." Meehan v. Valentine, 145 U. S. 611, 623.

See notes 18, 19, 24, 25, 27, 37, 38, 39.

The opinion in this case states: "The lease shows that the parties to it are, in a very practical sense, committed to and engaged in a common venture for their mutual benefit. The lessors have put into the venture their right to explore for and to extract the oil under their lands, and the lessee has put into it various drilling and pumping appliances and much expense, labor and time. All that has been put in is devoted to the common purpose of producing oil in which the lessors and the lessee are to have stated interests. It is this production that is taxed against the lessors and the lessee according to their respective interests."

4. See notes 5, 7, 10, 11, 13, 14, 15, 16, 18, 19, 24, 25, 27, 38, 39.

FIRST. The oil and gas lease is in reality a grant

5. Texas Co. v. Daugherty, 107 Tex. 234, 176 S.W. 717, L. R. A. 1917-F, 989, Stephens County v. Mid-Kansas Oil & Gas Co. 254 S. W. 290, (Sup.) in which the Court said: "The opinion in that case (the Daugherty case) leaves no room for reasonable doubt as to the soundness of the conclusion that gas and oil in place are objects of distinct ownership and sale as a part of the land. * * * Ownership of the gas and oil in place meant having the exclusive right to possess, use and dispose of the gas and oil. The *grantors* were clearly divested of the right to either possess, use, or dispose of the gas and oil in place in the lands described in the instruments here involved as soon as the instruments were executed. At the same instant, the right to possess, use and dispose of such gas and oil in place passed to the *grantees* in said instruments and to their assigns. Complete divestiture of title to the gas and oil could hardly be more completely evinced than by the necessity for an express reservation of even enough gas for domestic use in the grantors' dwellings. Dominion over a thing could not well be completer than it is in those persons who may, at their will, assign it to any other, with or without consideration, for a time which may be forever." The leases thus construed are not different in substance than those in the record in this case, and the court observed that any instrument which showed a purpose to grant the right to take the oil would be similarly effective.

Brewster v. Lanyon Zinc Co., 140 Fed. 801, 807, in which Mr. Justice Van Devanter, while on the Circuit said: "Although the parties, with the sanction of a general practice, denominated the instrument a 'lease,' strictly speaking it was not such, but was more in the nature of a grant in præsenti of all the oil and gas in the lands described—these minerals being part of the realty—with the right to enter and search for them, and to mine and remove them when found."

which may continue forever, but which may also terminate upon cessation of use thereof for the production of oil and gas; it creates an estate in land "called a base, qualified or determinable fee," defined by Kent as "an interest which may continue forever, but the estate is liable to be determined, without the aid of a conveyance, by some act or event, circumscribing its continuance or extent.' "[6]

SECOND: All the interest which the lessor has is real property. The so-called royalties are in reality payable as rent[7] and constitue the consideration[8]

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6. Stephens County v. Mid-Kansas Oil & Gas Co., supra, Waggoner Estate v. Sigler Oil Corporation, 118 Tex. 517, 19 S. W. (2) 27, Sheffield v. Hogg, infra n 10.

7. Von Baumback v. Sargent Land Co., 242 U. S. 503, 522, where it was said that the sums payable to a lessor under a mining lease "were in facts rents or royalties to be paid upon entering into the premises and discovering, developing, and removing the mineral resources thereof, and as such" are income, under the corporation tax law, to be taken into account in determining the amount of tax payable by a corporation "engaged in business." The Court held the lessor corporation in this case subject to the excise, not because of the mere receipt of the rentals, but because it was actively engaged in business within the meaning of the law.

Guess v. Harmonson, 4 S. W. (2) 124, in which it is held that: "Royalty is another term for rent, but is limited to rents due for the right or privilege of taking minerals, oil or gas out of a designated tract of land."

Hill v. Roberts, 284 S. W. 246, 249, in which it is

for the grant. This is true whether the rent be considered as payable in the form of service,[9] that is, for delivering the lessor's royalty oil, or whether it

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said that: "The word 'royalty' as used in a gas lease, generally refers to 'a share of the product or profit reserved by the owner for permitting another to use the property.' "

Sheffield v. Hogg, 77 S. W. (2) 1021, infra n. 10.

For other similar definitions see Glassmire "Law of Oil and Gas Leases and Royalties" (1935) Sec. 11.

8. Freeport Sulphur Co. v. American Sulphur Royalty Co., 6 S. W. (2) 1039, 1043, in which it is said that: "It is apparent, however, that the royalty contracted for and the $1 per ton on 200,000 tons on first production was at least a *consideration* specifically provided for. * * * The royalty of 75 cents per ton on all sulphur produced and the additional $1 per ton on the first 200,000 tons mined were a part of the consideration for the sale of the property."

9. Mills-Willingham, Law of Oil & Gas, pp. 173-8: "At common law it was quite competent to make a rent service or rent charge the entire consideration for the transfer of an estate in fee. The character of the rent thus reserved does not appear to have been materially altered by the fact that it was purchase price. Nor does the law appear to have distinguished between rents proceeding from ordinary usufruct and those proceeding from a part of the corpus. Both were a profit or rent. Both were inseparably connected with the land so that a grant of all the rents and profits was a grant of the land itself."

Blackstone's Commentaries, Vol. II, p. 41, infra n. 11.

be considered that the royalty oil itself is the rent.[10]

10. In Sheffield v. Hogg, 77 S. W. (2) 1021, the Supreme Court of Texas had under consideration the question whether the royalty interest of a lessor was taxable as realty, in the county where situated, or as personalty in the county of the owner's residence. Some of the involved leases provided for payment of royalty in kind, others for the payment of a stipulated amount based on production. The Court said: "The question before us is: What was the interest of the lessors under the instruments through which they claim in each of the cases now before us? Despite differences in their phraseology and forms, we have concluded after careful consultation and deliberation, that the lessors interest, sought to be taxed in each instance, or that of his assign, was an interest in land, subject to taxation as such in the counties in which the respective tracts of land are situated." "*All the property interests of ascertainable value, secured to the lessors or their assigns * * * are subject to taxation as real estate in the county wherein the land lies.*"

This holding was not made without the gravest consideration, it is fortified by a historical background in Texas jurisprudence which proves indisputably that ALL THE LESSORS INTERESTS under the lease are REAL PROPERTY.

The Court quoted approvingly from the opinion in United States v. Noble, 237 U. S. 532, 533, in which the question was whether restrictions on alienation of allotted Indian land, applied to royalty reserved under a valid lease thereof in which this Court had said: " 'The rents and royalties were profit issuing out of the land. When they accrued, they became personal property; but rents and royalties to accrue were a part of the estate remaining in the lessor. * * * ' " Continuing, it said:

"The principle underlying the determination in U.

Signification of the lessor's interest as rent, refutes

S. v. Noble supra, that the mineral royalties there under discussion constituted interest in land, had been announced in that tribunal as far back as 1823, when in an opinion by Mr. Justice Washington, the Court said: "A right to land essentially implies a right to the profits accruing from it, since, without the latter, the former can be of no value. Thus, a devise of the profits of land, or even a grant of them, will pass a right to the land itself. Shep. Touch. 93, Co. Litt. 4 b. 'For what' says Lord Coke, on this page, 'is the land, but the profits thereof.' Green v. Biddle, 8 Wheat. 1, 76.

"On the subject of rents and profits from lands, Mr. Thompson says:

" 'Rent is said to be a certain yearly profit arising out of lands and tenements as compensation for the use thereof. * * *

" 'Thus, if the grantor conveys a fee simple title in the lands, reserving rent, he himself has a fee simple in the rent. * * * A rent reserved upon a conveyance of land with words of inheritance, is real property and passes to the heirs of the grantor. * * *'

"Mr. Tiffany is in full accord with Mr. Thompson. According to Mr. Tiffany: 'A rent reserved on the grant of a fee simple estate in land is real property.' * * *

"On the subject of taxation of interests under oil and gas leases, Mr. Summers significantly notes that:

" 'Where, under the ordinary lease, the lessor retains a certain share of the oil or gas as a royalty, the value of such interest may be added to the agricultural value of the land for the purpose of making the assessment.' "

See Carpenter v. Shaw, 280 U. S. 363, infra n. 16.

the idea that there is a community of interest.[11]

Not only is it the law of Texas that "ALL THE PROPERTY INTERESTS * * * SECURED TO THE LESSORS * * * ARE SUBJECT TO TAXATION AS REAL ESTATE IN THE COUNTY WHEREIN THE LAND LIES,"[12] but this construction of the statutory definition of real property[13]

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11. Blackstone's Commentaries, Vol. 2, p. 41:

"The word rent * * * signifies a compensation or return, it being in the nature of an acknowledgment given for the possession of some corporeal inheritance. It is defined to be a certain profit issuing yearly out of lands and tenements corporeal. * * * It may also consist in services or manual operations; as, to plough so many acres of ground, to attend the king or lord to the wars, and the like; which services in the eye of the law are profits. * * * It must issue out of the thing granted, and not be part of the land or thing itself; wherein it differs from an exception in the grant, which is always of part of the thing granted. * * * A rent cannot be reserved out of an advowson, a *common*,[a] an office, a franchise or the like."

a. (COMMON—The right of taking a profit in the land of another, in common either with the owner or with other persons—so called from the community of interest which arises.—Webster Dict., Bouvier's Law Dict.)

12. Sheffield v. Hogg, n. 10, supra.

13. Art. 7146, R. S. 1925: "Real property for the purpose of taxation, shall be construed to include the land itself, whether laid out in town lots or otherwise, and the buildings, structures and improvements, or other fixtures of whatsoever kind therein, *and all the rights and privileges belonging or in any wise appertaining thereto, and all mines, minerals, quarries and fossils in and under the same.*"

which was one of the considerations that lead the Court to hold in Sheffield v. Hogg, supra, that ALL of the lessor's rights are real estate[14] is grounded deep in our law.

It has long been settled by cases cited in that opinion or to which the cited cases refer, that the rights, franchises and privileges incident to the ownership of land are substantially a part of it,[15] and that such

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14. In Sheffield v. Hogg, supra, the Court said (p. 1030): "Reading the Constitution and statutes together; there is no escape from the conclusion that the interests herein involved are meant to be taxed as real estate. Classify them as you may, they are at least rights or privileges belonging or in some wise appertaining to real property, and the Legislature has provided that they be taxed as such."

15. In Texas Company v. Daugherty, supra, the Court, after quoting the statute (supra n. 13), said that: "The rights and privileges belonging to land contribute in a very substantial way to its value. They largely cause it to yield its income, and it is the theory of our statute, therefore, that their value shall be included in the valuation of the land for taxation in the hands of the owner. They do not escape taxation by this method; on the contrary they are subject to its burden through the inclusion of their value in the assessment of the land; and they are taxed against the owner of the land because the Legislature has deemed it proper for him to bear their charge in view of their essential contribution to its value." Citing State v. Austin & N. W. R. R. Co., 94 Tex. 530, 62 S. W. 1050, in which the Court, construing the same Article of the Statutes, said:

"It seems to us the plain purpose of the article last

rights are to be carefully distinguished from the pur-

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quoted (is) to require that in assessing real estate for taxation, whether held by a natural person or a corporation, there shall not only be included in the valuation the value of the land itself merely as land, together with the improvements thereon, but also all franchises and privileges appurtenant thereto, and all the advantages for a profitable prosecution of the business to which it is appropriated. As a rule, the value of improved real estate is proportionate to the net income which it will yield. * * * In valuing a railroad for taxation, the valuation should include every right and privilege which was exercised in producing its income, and * * * it was not intended to disassociate the soul from the body of the living concern, and value by itself the lifeless remains. If we are correct in this conclusion, then it follows that it was not the intention of the Legislature to tax the franchise of the railroad separate from its real estate. TO SO TAX IT WOULD LEAD TO DOUBLE TAXATION, WHICH IS NOT PERMITTED."

But the Court did not fail to discriminate between the franchises that are inherent in ownership of property, and those which exist independent thereof, and are separately subject to an excise. It said that among the personal property required to be listed for taxation are *franchises*, and the value thereof, and that such franchises are " 'special privileges conferred by the government on individuals, and which do not belong to the citizens of the country generally, of common right.' * * * Under this definition it seems to us that the ordinary franchises of a railroad corporation are the right to exist and to transact business as a corporation, and the right to condemn property to its uses."

suit of an occupation—the lawful subject of an excise—in which property may be employed.[16]

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16. In State v. G. H. & S. A. Ry. Co., 97 S. W. 71, 77, the Court said:

"The fact that the franchise is subject in this state to an ad valorem tax as property does not militate against the right to tax the persons or the corporations using that property as an occupation any more than would the taxing of the physical property of the railroads, as the tracks, right of ways, cars, etc., operate to prevent the imposition of occupation taxes for the use of them as instruments of transportation. * * * As well might it be held that an ad valorem tax upon a storehouse, fixtures, and goods would preclude an occupation tax upon the merchant for pursuing the business of selling the goods."

"Since a corporation can carry on no business except that for which it holds a franchise from the state, it follows that *any tax levied upon a corporation in this state for exercising the privilege of carrying on its business must be classed as an occupation tax under our constitution, and in all tests of the validity of such a tax, those provisions of the Constitution which apply to occupation taxes must be the standard.*" (Citing Article VIII, Sec. 1 of the Constitution, which is quoted on page 53 of our original brief).

In Producers' Oil v. Stephens, 99 S. W. 157, it was held with respect to the original gross production tax on producers of oil that:

"The tax is not upon the gross products of the oil wells, but upon the occupation of owning, controlling, or managing oil wells, producing oil; and the amount of the tax is measured by a percentage of the market value. * * * Although this law imposes an occupation tax upon the oil producers who pay an ad valorem tax upon the real estate producing oil, it does not constitute double taxation, not permitted by the law, as

An occupation is certainly not appurtenant to any

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it is within the authority of the Legislature to impose an ad valorem tax for the USE of this property in the PRODUCTION OF OIL."

Shortly thereafter in Texas Co. v. Stephens, 103 S. W. (Tex. Sup.) 481, 484, the Supreme Court had occasion to consider the holding in the Producers' Oil Company case. It said: In the case of Producers' Oil Co. v. Stephens, 99 S. W. 157, in which this Court recently refused a writ of error, the point was made that the tax levied by section 13 of the act under consideration upon producers of oil was a tax upon property; but the courts below held otherwise, and this Court in refusing the writ of error approved the holding. *The taxes in the act are levied because the persons specified are engaged in particular, defined businesses, and are laid upon the carrying on of those businesses. The amounts of the taxes to be paid by those engaged in the businesses are to be ascertained by various standards depending upon the character of such businesses, but in no instance is a tax laid upon all or any of the property owned by such persons.* Had the statute simply defined the business and imposed a tax of a fixed sum upon each, no one would have questioned that it was a tax upon the doing of the businesses; in other words, an occupation tax. The fact that the amount of the tax is to be determined in prescribed methods, from the value or extent, or magnitude of the businesses done, cannot convert it into an ad valorem tax upon the property of the persons conducting them."

Because the law laid the occupation tax equally upon all persons of the class selected to bear it, this Court affirmed the decision of the Texas court in a companion case (100 S. W. 489) Southwestern Oil Co. v. Texas, 217 U. S. 114.

Cf. Carpenter v. Shaw, 280 U. S. 363, in which this

particular property. If it clearly appears that a so-called excise falls on property, it violates our State Constitution, regardless of its characterization.[17]

Court held the Oklahoma 3% Gross Production Tax was a property tax on the lands of an Indian lessor which were exempt from taxation by Federal law. The Court said: "We think it plain that the tax * * * is, by its very terms, a tax upon the right reserved in them as lessors and owners of the fee. * * * The Oklahoma Courts * * * * have treated the royalty interest of the lessor as a right attached and incident to his ownership or reversionary interest in the land. * * * But even if this did not appear to be the case, an interest commonly so associated with the use and enjoyment of the allotted lands could not, under the rule of liberal construction rightly invoked by the petitioners, be deemed excluded from the benefits of the exemption granted." The Court rejected the view that the tax was on the royalty after it was produced, and therefore on personalty.

17. Notes 14, 15, 16.

In Dawson v. Kentucky Distilleries, 255 U. S. 288, 291, it was said: "The attorney general concedes that the tax, if a property tax, is invalid since it does not comply with the requirements of a property tax specified in * * * the State Constitution. * * * He contends * * * that the tax is * * * a license tax upon 'the business of' * * * owning and storing * * * 'spirits in bonded warehouses.'" The Court held the law imposed a property tax and as such was concededly invalid, agreeing that the thing really taxed "is the act of the owner in taking his property out of storage into his own possession * * * for the purpose of making some one of the only uses of which it is capable * * * To levy a tax by reason of ownership of property is to tax the property."

THIRD: It has never been supposed that a community of interest or reciprocal relation arose between a grantor and grantee, because the consideration for the grant of a freehold estate was payable in installments, or in a particular way, or was reserved as rent, or because the grant was limited to a specified use, or was upon a limitation or condition.

Would a villein be held to have become engaged jointly with his lord, because he held by rent service?

Would a landlord of this day, renting on shares, furnishing the teams, seed, etc., be engaged in a common enterprise with his tenant?

Would a landlord who erected a building for the special use of his tenant, reserving as rent a share of the profits, be engaged in a common undertaking with the tenant?[18]

Would a lender of money, who reserved a share of the profits of a particular enterprise, in lieu of interest, be engaged in a joint venture, with the borrower?[19]

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18. **"An agreement that the lessor of a hotel shall receive a certain portion of the profits therof by way of rent does not make him a partner with the lessee." Meehan v. Valentine, 145 U. S. 611, 623-4.**

19. "The partnership relation does not exist where the interest in net profits is by way of compensation or remuneration for: (1) services as clerk or other employee (Goode v. McCartney, 10 Tex. 193); (2) commission as agent or broker (Buzard v. Bank, 67 Tex. 83, 2 S. W. 54, 60 Am. Rep. 7); (3) *rental for property real or personal* (Fink v. Brown (Tex. Com.

Surely, the intention of the parties is controlling, even if a question of taxation is involved.[20] The lessee contracts with the lessor because he is in, or wants to get into the business of producing oil—not because he intends to engage in it with the lessor.

A careful search has failed to disclose a single case or text in which it was even contended that there was anything in the nature of a joint purpose in the minds of the grantor and grantee of an oil and gas lease.

Landlord and tenant and vendor and vendee,[21] ten-

App.) 215 S. W. 846); (4) *interest on money loaned* (Kelly Island Lime & Transport Co. v. Masterson, 100 Tex. 38, 93 S. W. 427, 430)" Gardner v. Wesner, 55 S. W. (2) 1104 by the Chief Justice of the Texas Court of Civil Appeals from whence this appeal came.

20. "The true rule * * * would seem to be that the agreement and intention of the parties themselves should govern in all the cases. If they intended a partnership in the capital stock, or in the profits, or in both, then that the same rule should apply in favor of third persons, even if the agreement were unknown to them. And on the other hand, if no such partnership were intended between the parties, then that there should be none as to third persons, unless where the parties had held themselves out as partners to the public, or their conduct operated as a fraud or deceit upon third persons." Meehan v. Valentine, 145 U. S. 611, 623-4.

21. After the production of oil, "the relation of landlord and tenant, or vendor and vendee is established." Mills & Willingham, Law of Oil & Gas, p. 72, citing Glasgow v. Chartiers Oil Co., 152 Pa. 48, 25 Atl 232, Venture Oil Co. v. Fretts, 152 Pa. 451, 25 Atl., 732.

ants in common,[22] and co-tenants[23] they have been called, but joint venturers, common owners of the business of producing, partners or mining partners—never.

But it has often been decided that a co-owner of a part of the *working interest* in an oil and gas leasehold, even though he holds under the lessee and must share in the expense of operation is not jointly engaged in the business of producing, by reason of title alone[24]—and this is in line with the cases here.[25] It

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22. Taylor v. Higgins Oil & Fuel Co., 2 S.W. (2) 288, 295.

But in Mills & Willingham "Law of Oil & Gas." p. 264 it is said that:

"The lessor and lessee of an oil and gas lease, however, are not tenants in common. The lessor, while he has the right of possession and other purposes has parted with the right of possession for the purpose of producing oil and gas, to the lessee, who is substituted in his place, consequently there is no UNITY of possession between them."

23. Gardner v. Wesner, infra pp. 20-22.

24. Notes 25, 27, 37, 38, 39.

In Bolding v. Camp, 6 S. W. (2) 94, 96, Bolding bought and paid for a 1/16th interest in an oil lease. It was contended he was a partner because he would thus be liable for a share of the expenses of operation; but the Court said: "The agreement on its face is one of tenancy in common. * * * It is urged that sharing of profits was contemplated. The evidentiary predicate is the purchase of the 'one-sixteenth interest' in the leasehold. * * * It might well be that Bolding bought a one-sixteenth part of the minerals in place; whatever inference lies is (we

25. Note 25 commences on page 22.

is only when there has been an engagement for ac-

think) to that end for whatever the nature of the leasehold he acquired that aliquot part of realty. * * * True it is, he might be charged, under given circumstances with a portion of the expense of severance, but the requisite circumstances are not shown and the charge hypothetized would arise in virtue of tenancy in common, and not because of partnership."

In 31 Texas Jurisprudence pp. 538-9, it is said: "When land containing oil and gas is owned by two or more persons in common, any one of them may extract the minerals regardless of co-operation by the others in the undertaking. If the other owners decline to participate, the producer cannot compel them to contribute to his enterprise; he must rely upon his own resources, and if he fails, he alone must bear the loss. On the other hand, if oil or gas is produced in paying quantities, the producer must account to the other owners for its value, after the costs of production and marketing have been deducted."

In Mills & Willingham "Law of Oil & Gas" pp. 274-275, it is said that:

"There is no relation of partnership, nor presumption of it, from co-tenancy itself, in a mine, or in an oil and gas lease. It arises only when the co-tenants actually begin operating the joint property. * * * There is a distinction in principle between the mining of solid minerals, and the production of oil and gas, in that in the case of oil and gas 'the production may be and usually is delivered to the pipe line and credited to each co-tenant, without ever having become a part of the social assets. * * * In which event there is no division of the profits and losses, as between the co-tenants * * * nor are there any social assets, unless jointly owned equipment could be so considered."

Dunnigan T. & S. Co. v. Carroll, 60 S. W. (2) 296, by the same judge who wrote the opinion of the Court

tual participation in the management of the prop-

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of Civil Appeals in this case, involved the question whether a contract between the owner of an oil lease and a driller, for the drilling of oil wells in part consideration for which the owner assigned a one-sixteenth interest in the lease, constituted a mining partnership. The Court said:

> "The manifest purpose of the drilling contracts was to obtain the drilling of certain oil wells for a certain stipulated consideration or compensation. They evidence no agreement of a joint undertaking or agency to operate the leases, and to share profits as such, but the contrary is clearly evidenced by the contract with Morgan, in that it provided that the specified interest to be assigned Carroll in the leases, or the specified amount of oil to be credited as a part of the compensation to him for drilling the first two wells. * * *
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> "It is therefore manifest that a mining partnership, as that relationship has been defined in law *as arising from joint operations and sharing of profits as such*, was not shown in this case; but *the contracts* themselves clearly *show* that *the parties contracted for the drilling of certain oil wells for a stipulated consideration, and not in consideration of sharing profits as such, or joint operation of a mining enterprise.* * * *
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> "In the recent case of Gardner v. Wesner (Tex. Civ. App.) 55 S. W. (2) 1104), 1106, * * * it was held that the joint ownership of the mining property will not alone create a mining partnership; but that, as was held in the cases of Wagner Supply Co. v. Bateman, 118 Tex. 499, 18 S. W. (2) 1052; Munsey v. Mills, 115 Tex. 469, 283 S. W. 754, and the other cases cited, 'joint operation, sharing of profits, community of interests, and the mutual agency' must also be

erty that the owners have been held to be mining

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shown in order to constitute a mining partnership. The Gardner Case further held that the mere 'sharing in net profits of mining venture does not create relation of mining partner,' and especially so where the terms of the agreement show the profits were paid as compensation for services rendered."

Gardner v. Wesner, 55 S. W. (2) 1104, by the Chief Justice of the Court from which this appeal came, involved the question whether a mining partnership existed between the owner of a lease who contracted for cleaning a well in part consideration for which it was agreed that the well cleaner should receive a one-eighth of the net profits from the well if it produced. The Court said:

"In order to constitute a mining partnership **(sometimes called a joint venture)** there must be not only a joint ownership of the mining property (which of itself creates only the relation of cotenancy), but also a joint operation. 'The actual working of the mine by the joint owners is essential to a mining partnership.' 22 A. & E. Ency. of Law, p. 228. This rule is so well established as to be now regarded as elementary (40 C. J., p. 1145; 18 R. C. L. p. 1200, Sec. 106; 2 Thornton's Oil & Gas (5th Ed.) Secs. 658-667; Summer's Oil & Gas, Sec. 235), and has been followed in this state whenever the question has been presented. Bolding v. Camp (Tex. Com. App.) 6 S. W. (2) 94; Leath v. Benton Abstract & Title Co. (Tex. Civ. App.) 9 S. W. (2) 501; Lowry Oil Corp. v. Bennett (Tex. Civ. App.) 16 S. W. (2) 947; Ferguson v. Rhoades Drilling Co. (Tex. Civ. App.) 271 S. W. 155; Adams v. Texhoma O. & R. Co. (Tex. Civ. App.) 262 S. W. 139.

"The Texas cases in which it has been held that

partners.[26] Where the question whether a partner-

a mining partnership existed presented the elements 'not only a joint ownership of the lease * * * but joint operation, sharing of profits, community of interests, and the mutual agency * * * in the management of the lease and exploration for oil.' Wagner Supply Co. v. Bateman, 118 Tex. 499, 18 S. W. (2) 1052, 1055; Munsey v. Mills & Garitty, 115 Tex. 469, 283 S. W. 754; Mayfield v. Key (Tex. Civ. App.) 260 S. W. 926; Indiahoma Ref. Co. v. Wood (Tex. Civ. App.) 255 S. W. 212.

"That sharing in the net profits of a mining venture does not create the relation of mining partner, was held in the early Colorado case of Le Fevre v. Castagnio, 5 Colo. 564. * * *

"The holding in that case has been uniformly followed in mining partnership cases, so far as we have been able to discover. The following Texas cases are directly in point: Lowry Oil Corp. v. Bennett (Tex. Civ. App.) 16 S. W. (2) 947; Leath v. Benton Abstract & Title Co. (Tex. Civ. App.) 9 S. W. (2) 501 (error dis.)

"In the law of partnership generally, the net profits rule, which at one time prevailed in England, has never been adopted in this state; although some expressions in Cochran v. Marmaduke, 60 Tex. 370, led to some confusion for a while, as to what exceptions to the rule should be applied. Fouke v. Brengle (Tex. Civ. App.) 51 S. W. 519; Rahl v. Parlin & Orendorff Co., 27 Tex. Civ. App. 72, 64 S.W. 1007. The decision in that case has been clarified by subsequent holdings of the Supreme Court, and it is now generally recognized in this state that to constitute a partnership there must be: 'A community of interests, the common enterprise, its

26. Note 26 is on page 23.

ship exists has been raised between co-owners of the

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operation for the joint account, and a right in the owner of each interest to share as a principal in its profits as such, which under the established rule in this state is a recognized test of the relation.' Freeman v. Huttig Sash & Door Co., 105 Tex. 560, 153 S. W. 122, 125, Ann. Cas. 1916E, 446.

"Specifically, it has been held that the partnership relation does not exist where the interest in net profits is by way of compensation or remuneration for: (1) services as clerk or other employee (Goode v. McCartney, 10 Tex. 193); (2) commission as agent or broker (Buzard v. Bank, 67 Tex. 83, 2 S. W. 54, 60 Am. Rep. 7); (3) *rental for property, real or personal* (Fink v. Brown (Tex. Com. App.) 215 S. W. 846); (4) interest on money loaned (Kelly Island Lime & Transport Co. v. Masterson, 100 Tex. 38, 93 S. W. 427, 430). * * *

"Conclusions from the authorities are summarized on pages 1105, 1106 of 18 L. R. A. (N. S.), one of which we quote: '*When the profit sharer is simply* an agent or servant, *one who furnishes property*, a lender of money, or a mere creditor, *who receives the profits as compensation for his services, for the use of his property* or money, or in order to collect his debt, *without more, he is not liable as a partner*, and the presumption is overthrown.'"

25. "The fact that real property is held in the joint names of several owners, or in the name of one for the benefit of all, is no evidence of co-partnership between them with respect to it. In the absence of proof of its purchase with partnership funds for partnership purposes, real property standing in the names of several persons is deemed to be held by them

working interest, and nothing but the fact of ownership has been shown, the cases have sometimes pointed out that they sustain more nearly the relation of lessor and lessee and are not mining partners.[27] **In all the cases, it is held that a joint venture cannot**

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as joint tenants or as tenants in common, and none of the several owners possesses authority to sell or bind the interest of his co-owners." Thompson v. Bowman, 6 Wall. 316, 317.

See Notes 3, 18 supra.

26. Notes 19, 24, 27, 39, especially Gardner v. Wesner, 55 S. W. (2) 1104, pages 20-22, supra.

27. "The rule is that a mining partnership arises by operation of law where co-owners work a mine. * * * The clause in the contract that Bateman's one-fourth interest 'is to be held as royalty interest' plainly shows that, as between the owners, his interest was to be free of cost to him, as royalty is ordinarily free of cost to the owner. The property rights, however, of Bateman, were not those of a royalty owner. He was not the original owner of the lease or the entire estate in the land, and he bought no royalty interest from anyone. Royalty is usually the amount reserved or the rental to be paid the original owner of the whole estate, and Bateman's interest does not come within the usual and ordinary signification of the term." Wagner Supply Co. v. Bateman, 18 S. W. (2) (Tex. Sup.) 1052.

Lowry Oil Corporation v. Bennett, 16 S. W. (2) 947, involved the question whether the defendants, each of whom "owned an undivided interest in an oil lease on the land mentioned above, and each was entitled under an agreement with the other co-owners, to a proportionate part of the net profits derived from the drilling of a well upon the land" were partners. The Court said:

exist when the profits are not shared as such, when there is no community of management, and where the profits are rendered as compensation for the use

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"Notwithstanding the fact that after the Lowry Oil Corporation became the owner of the interests in the lease it would be entitled to share in the profits arising from the development of the lease, yet, under the undisputed facts recited above, it could not be held liable as a partner with Ferguson for the oil purchased by the latter Bolding v. Camp (Tex. Com. App.) 6 S. W. (2) 94; Fink v. Brown (Tex. Com. App.) 215 S. W. 846, and authorities there cited—all to the effect that the rule that a mere sharing in the profits fixes the relation of partnership does not obtain in this state. Ferguson v. Rhoades Drilling Co. (Tex. Civ. App.) 271 S. W. 155; Humble Oil & Refining Co. v. Strauss (Tex. Civ. App.) 243 S. W. 528; Mills & Amsterdam Cas. Co. v. Harrington (Tex. Civ. App.) 11 S. W. (2) 533 (writ of error dismissed). * * *

"With respect to the question of partnership growing out of that transaction, in principle, Jackson's relation to the development of the lease as a result of Ferguson's contract with him to convey him a one-sixteenth interest in it and to drill the well thereon, for the consideration of hauling the rig, *was not different from that of the owner of land who conveys an interest therein in the way of an oil lease, and in consideration therefor the lessee agrees to develop the lease for oil and gas and to pay the lessor a one-sixteenth or some other portion of the oil, which, under authorities cited above, would not create a partnership relation between the lessor and lessee.*"

of money, property, chattels, services, and the like.[28]

FOURTH: Considering the lessor's interest under a lease as rent, it becomes perfectly clear that the doctrine of implied covenants to which reference has been made has to do with the lessor's right to rent and does not alter the relation between the parties. Under this doctrine the lessor is entitled to rent within a reasonable time and in a reasonable amount, whether the lessee produces oil or not.[29] This right to full compensation for the rights and privileges granted to the lessee, has none of the incidents which

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28. Notes 19, 24, 27, 39, Gardner v. Wesner, pages 20-22 supra.

29. "Where a mining lease provided for oil or gas royalties, and failed to define the lessee's duty as regards development after discovery of oil or gas, the law implied the obligation from the lessee to continue the development and production of oil or gas with reasonable diligence. * * *

"The usual remedy for breach of the lessee's implied covenant for reasonable development of oil and gas is an action for damages. * * *

" 'So long as the sulphur company breaches or violates its contractual duty to operate one plant, the royalty company may recover its compensation for the full amount of sulphur that should have been produced as contemplated by the contract.' (Freeport Sulphur Co. v. American Sulphur Royalty Co., 6 S. W. (2). * * * "The true basis of the whole doctrine of implied covenants in oil and gas leases may be found in the determination of courts to enforce fair dealing between lessor and lessee which could not otherwise be assured." Waggoner Estate v. Sigler Oil Co., 19 S. W. (2) 27, 29.

attend the commitment of one man to another in common purpose.

FIFTH: Oil leases are bought by persons and corporations engaged in the business of producing oil. Their activity in the business is not an appurtenance or franchise which exists by virtue of the ownership of any particular lease. It is a right that exists and has its value, entirely distinct and independent of the ownership of a lease.[30] The lease comes into the picture as a part of the means by which the business is conducted.

The lease is not put into a common undertaking, with the lessee, it is outright sold and granted. The lessor's reserved rights are subject to sale in various ways. He may grant a fraction of the reversion, a part or all of the royalty on a part or all the land affected by the lease, a part of the delay rentals or bonuses on present or future leases, and under Sheffield v. Hogg, all these are real property. Such grants carry with them the entire interest of the lessor, as far as they go. Glassmire[31] estimates that one-half million individuals and companies in the United States are the owners of petroleum royalty interests. These interests are often so divided that an interest holder is entitled to no more than one out of every million and a half barrels of oil and it is not uncommon to see more than two hundred royalty owners under a single lease.

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30. Note 16 supra.

31. Glassmire Law of Oil & Gas Leases and Royalties (1935) p. 54.

The tax in question falls on all these interests and people, regardless of where they reside—some even in foreign countries—thousands who were never in the State of Texas and never saw an oil field. Yet, they are declared to have intended to engage in a joint venture in this State, solely by virtue of a grant of real property.

A part of the Cook Estate royalty was put into an endowment fund for a hospital; and the hospital is declared to be engaged in a mining venture.

Large royalties are held by corporations, restricted Indians, banks, minors, insane persons, Trust Companies, schools, lawyers and judges, and they are all declared to be committed to a common undertaking with the producer of their oil.

On the basis of one million barrels per day production, which is a low average, the tax on royalty owners in Texas, exceeds Nine Hundred Thousand Dollars per annum.

SIXTH: While we agree and argued that the Court of Civil Appeals intended to hold the law laid an excise on the production of oil—an occupation tax under our Constitution[32]—WE KNOW IT DID NOT INTEND TO OVERRULE ALL THE DECISIONS BY WHICH THE LESSOR-LESSEE RELATION HAS BEEN ESTABLISHED TO BE THAT OF GRANTOR AND GRANTEE OF A FREEHOLD

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32. Note 16 pp. 12-14, supra.

ESTATE[33] IN WHICH THE GRANTOR RESERVED A RENT AS CONSIDERATION FOR THE GRANT,[34] **and all the cases defining mining partnerships and common ventures**—the best of which it decided itself only a short time ago[35]—which have been extensively quoted from in the notes set forth in this petition. These decisions, coupled with the entire absence of any considered authority holding the lessor and lessee are engaged in a common enterprise or mining venture by virtue of the terms of an ordinary oil lease, conclusively demonstrate that they are merely grantor and grantee—and this is so well understood in all the oil fields and in Texas that it is but rule of thumb law. We predict a decision to the contrary will never be followed when an issue arises between the lessor and lessee or third persons, as to the intent and construction of an oil lease. Surely out of the myriad of cases where this and analogous relations have been involved, a lessor or grantor would have long ago been put in the category of a partner if it had been imagined he was such. Countless times an eye has been longingly cast in his direction when a lessee failed and left unpaid

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33. Notes 5, 10, 21, 27, 39.

34. Notes 7-11, 18, 19, 21, 22, 24, 27, 38, 39.

35. Notes 18, 19, 24, especially Gardner v. Wesner, supra, pp. 20-22.

claims, and sometimes a lien has been sought against his interest, with no avail.[36]

* * * * * * * *

Thus, the case comes back to the argument we originally submitted. The Court of Civil Appeals simply attempted to justify an excise because of the ownership of property.

While the Court of Civil Appeals said that one of the purposes of the lease was the future development and operation of the lease for oil, in accordance with its terms, for the "mutual benefit" of the parties, it **certainly did not say that this "mutual benefit" resulted from joint operation of the prop-**

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36. "Ordinarily one can only subject to a lien such interest in real property as he may have. So the lessee subjects the lease to a lien, but the lessor's reversion is in no way involved. Mills & Willingham "Law of Oil and Gas," p. 346.

"So the lessee is not the agent of the lessor for development of the lease and the lessor is not personally liable to laborers and materialmen." Id. p. 348, citing Thompson v. Hickman, 262 S. W. (Ark) 20, which holds that neither the lessor personally, nor his reversionary interest are liable to pay employees of the lessee where he does no more than accept the benefits accruing to him under an oil and gas lease.

And when the lease ceases to exist, the lien also dies. Kelley v. Shamburger Lumber Co., 23 S. W. (2) 883.

erty—which is indispensable to a joint venture.[37] What it meant was that development of the lease would result in such benefit or profit as any ordinary contract contemplates.

Nor did the Court hold that the oil produced was shared or divided as profits of an enterprise; indeed, it could not dispute the many holdings that so far as the lessor's interest is concerned **it was deliverable as compensation for the granted privileges.**

"The *consideration* moving to the lessor (as rent for the grant of a freehold) is an *interest* in the oil or its value in money." But, the *consideration* was payable as rent for a grant, and is real property;[38]

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37. Notes 18, 19, 24, 25, 27, 39. In Gardner v. Wesner, supra, the Court said: "In order to constitute a mining partnership (**sometimes called a joint venture**) there must be not only a joint ownership of the mining property (which of itself creates only the relation of co-tenancy) *but also a joint operation.* 'The actual working of a mine by the joint owners is essential to a mining partnership.' "

38. Notes 7, 8, 9, 10, 11, 14, 15, 24, 39.

"Thus, if a party has no interest whatsoever in the capital stock and as between himself and the other parties, has also no rights as a partner, or no mutuality of powers and duties, but is simply employed as an agent, and is to receive either a given sum out of the profits, or a proportion of the profits, or a residium of the profits, beyond a certain sum, as a compensation for his labor and services as agent of the concern, and not otherwise; he will not be deemed a partner in the concern from the fact alone; nor a partner with the others inter sesse, for that would be contrary to their intentions and objects, nor

not "mutual profits" or a "mutual" sharing of the oil. The fact we receive part of the oil as compensation for a grant of our land is no evidence that we have a community of interest in the production of oil on it.[39] Thus the indispensable elements of a

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as to third persons, because the transaction admits of a different interpretation, and may justly be deemed a mere mode of ascertaining and paying the compensation of an agent, as in a naked case of agency. *In such a case it may be properly enough said that the agent is entitled to a share or portion in the profits, liquidated or unliquidated and therefore that he has in a certain sense a community of interest therein, with the actual partners. But he does not participate therein as an owner pro tanto, or as possessed thereof per my et per tout, or as clothed with the rights and powers and duties of a partner.*" Story on Partnership, Sect. 32.

" 'In order to constitute a communion of profits between the parties, the interest in the profits must be mutual, that is, each person must have a specific interest in the profits, *as a principal trader*. He is not a partner if he merely received out of the profits a compensation for his trouble, in the character of an agent or servant of the concern.' " Story on Partnership, Sect. 33.

39. Notes 5, 7, 10, 38.

"Mining partnerships by operation of law are based on *joint ownership* and *joint operation* of the mineral estate. There must be an existing mineral work and operation; joint ownership of the land alone is not enough." 32 Tex. Jurisprudence, p. 246.

"The ultimate fact to be shown is common ownership of the business and its profits; but the conclusion that a partnership is disclosed does not follow

joint venture are lacking.[40]

The lessor's "interest in the success of the business"

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as a matter of law from proof of joint interest in a contract and a right to share profits." Id p 245.

"Common ownership of chattels or of land does not amount to a partnership between the owners. Id. p. 252.

"A lease ordinarily does not create between lessor and lessee, contrary to their intention, a partnership because it reserves a share of ultimate net profits from operation of the leased plant and business for which a fixed rental is to be paid in any event. Nor does a partnership exist by reason of a lease of space in a department store for a percentage of net sales which designates the parties as lessor and lessee and which creates no community of interest. Id. p. 259.

"In a tenancy in common each party has a separate and distinct, although an undivided interest, and possesses (as it is technically expressed) the whole of an undivided moiety of the property, and not an undivided moiety of the whole property; whereas in partnership the partners are joint owners of the whole property. Story on Partnership, p. 134.

"In every case of partnership there is a community of the property of the partnership between the parties as soon as it becomes part of the common stock. * * * Partners therefore are to be treated * * * as * * * having an interest * * * in, and the entire possession, as well of every parcel, as of the whole. This principle * * * seems to result directly from the nature of the contract of partnership, which supposes, that the property brought into it is put into community by the joint consent of the parties. Story on Partnership. Sects. 15-16-17.

40. Note 24.

is economic, and not joint or of a community character. We are all interested in the success of the business of those with whom we contract, especially if they covenant to do us an independent service that we are prohibited from doing by the same contract. We would have a different interest in a common business, for under Texas law, having a joint right in the whole, we would have something to do with its success.[41]

The right to enforce the duty of a lessee to pay rent whether upon the express or the implied terms of the lease,[42] is a property right and denotes the opposite of joint or common working of an oil well. If the operation were joint there could be no such thing as an implied covenant upon the part of the lessee to reasonably develop and produce, as both the lessor and lessee would then be responsible for the failure to enlarge the activity.[43]

The reason the Court of Civil Appeals did not say the lessor and lessee were joint venturers is thus readily apparent from its own decisions and the common law of oil and gas. NOTHING IN COMMON BETWEEN THE LESSOR AND LESSEE REMAINS BUT COMMON OWNERSHIP OF THE OIL AND A DUTY TO PAY RENT.—THESE ARE PROPERTY.

The tax is in truth upon the lessor's rent and not

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41. Note 24.

42. Note 22, 24, 37, 38, 39.

43. Note 29.

upon the production of oil; it falls upon those who have interests in the oil produced, solely by reason of their interests and not because of any joint share or common purpose in the production, or common or mutual benefit therefrom.

The New Mexico case, Flynn v. State Tax Commission, 23 Pac (2d) 889, 892, assumes an element which is not present in this case, in the *dicta* quoted in the opinion, when it says that the lessee and royalty owner "*considered as participating in a joint enterprise*, are both engaged in the business of producing oil." Of course, assuming that it was shown they were jointly engaged in producing oil, the result is correct, for there is nothing in their relation to prevent them agreeing upon joint operation or engaging in a joint venture. We think from the whole opinion in that case the Court meant to say that if it were shown that they jointly operated the property they would be liable for the tax as producers, but that it was unnecessary to determine the question. In view of the long established principles set forth in the notes hereto it should require more than dicta to convince one that there is anything in an ordinary oil lease which creates the relation of joint venturers between the lessor and lessee therein.

The Supreme Court of Louisiana reached the correct result in State v. Stiles, 68 So. 947, when, interpreting a similar law it said that: "Article 229 of the Constitution does not provide for imposing a license tax upon the land or royalty owner, but only *upon those engaged in the business of severing natural resources from the soil.* * * * Our conclusion is that the expression in the second section of the stat-

ute, 'less the royalty interest accruing to the owner thereof, merely deprives the state of so much revenue; and that the proceeding clause *'the license on which shall be paid by said land or royalty owner'* has no effect whatever. *If the Legislature had undertaken to impose this license tax upon land or royalty owner, NOT ENGAGED IN THE BUSINESS OF SEVERING NATURAL RESOURCES FROM THE SOIL, it would have been without any constitutional authority."*

Having, as we believe, shown beyond all doubt that this Honorable Court did not correctly interpret the meaning of the Court of Civil Appeals; that the opinion of the Court below merely evaded the issue,[44] and that under the settled law relating to oil and gas,[45] the excise falls directly on our property rights and not on any privilege we have in relation to the production of oil, we respectfully submit that the law in question arbitrarily ignores substantial facts when it declares the owners of royalty interests in the oil produced to be engaged in the business of producing oil, and that the sole object of the law was to increase the income of the lessee and decrease that of the lessor proportionately, in the guise of an excise, or occupation tax, as it is called, under our Constitution.

Respectfully submitted,

WILLIAM R. WATKINS,

Attorney for Appellants.

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44. See our original Brief pp. 21-27.

45. B & W Taxi Co. v. B & Y Taxi Co, pp 57-59 our original Brief.

This petition is presented in good faith and not for delay.

WILLIAM R. WATKINS,
Attorney for Appellants.